THE WHITE HOUSE

WASHINGTON

June 11, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for June 14 Meeting

The agenda and papers for the June 14 meeting of the Economic Policy Council are attached. The meeting is scheduled for 4:30 p.m. in the Roosevelt Room.

The first agenda item is an overview of U.S.-E.C. trade relations. At the June 5 meeting, the Council requested the Department of State and the Office of the U.S. Trade Representative to prepare a strategy paper for U.S.-E.C. trade relations. A copy of that paper is attached.

The second agenda item concerns Cook Inlet crude oil exports. The Department of Energy has prepared an options paper on the issue of whether the Administration should pursue the actions necessary to permit the export of Cook Inlet crude oil. A copy of that paper is also attached.

Attachments

~~Confidential~~ Attachment

THE WHITE HOUSE

WASHINGTON

ECONOMIC POLICY COUNCIL

June 14, 1985

4:30 p.m.

Roosevelt Room

AGENDA

1. U.S.-E.C. Trade Relations

2. Cook Inlet Crude Oil Exports

UNDER SECRETARY OF STATE
FOR ECONOMIC AFFAIRS
WASHINGTON

June 11, 1985

CONFIDENTIAL

MEMORANDUM FOR MR. ROGER PORTER
THE WHITE HOUSE

SUBJECT: Strategy Paper on US-EC Trade Relations

In response to the request of the Economic Policy Council at its meeting of June 5, I enclose a paper prepared jointly by the Department of State and the Office of the US Trade Representative on a strategy for US-EC trade relations. The paper has been approved by Deputy Secretary Dam and Ambassador Smith. I assume you will circulate it to the members of the Council in advance of the meeting on June 14.

Allen Wallis

Allen Wallis

Attachment:

As Stated.

CONFIDENTIAL
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STRATEGY FOR US-EC TRADE RELATIONS

I. Introduction

In a sense, US-EC trade relations have been "poor relatives" of our security ties through NATO and bilateral relations with member states. In turning over trade issues to the Commission, our European allies have tended to see them as on a separate and unrelated track. This dichotomy, inherent in the formation of the EC, becomes a particular problem only if trade issues are handled by the Commission with little or no sensitivity to their impact on the international trading and monetary system. This now seems to be the case. At the working level a degree of mutually reinforcing frustration has entered into the treatment of issues on both sides of the Atlantic. Should such trends continue, the resulting serious threat to the international economic system would also undermine the political/security Alliance, which rests on an assumption of economic as well as strategic cooperation.

The overriding objective of the proposals made in this study is to reinforce and deepen comprehension in Europe that economic issues are inseparable from the rest. To do this, we propose a strategy for coordinating US approaches to individual issues, with an eye to timing as well as to substance and to the effect actions in each individual area may have on other economic objectives, on the overall US-European relationship, and on Congressional support for maintaining the international trading system.

In the end, despite our best efforts, it may not be possible to negotiate settlements of all our problems with the EC on terms consistent with our trade interests. Should this happen, we ought to work with the Community to limit the impact on other areas of our relationship of any trade actions we take.

Finally, in the event the EC is not able to muster Community-wide support for trade liberalization initiatives, we should not allow this policy divergence to weaken our own commitment to freer international trade.

II. Inventory of Problems

1. Agriculture

The EC is our second largest agricultural customer and our major competitor in world markets. Its Common Agricultural Policy (CAP) has encouraged over-production, and reduced our market access, a process we expect to continue as the Community moves to replace imported with domestically produced feed. CAP subsidies have played a large part in displacing US agricultural sales (as well as sales by other traditional exporters) in third country markets.

The EC has adamantly resisted solutions it interprets as opening to question the CAP structure of price supports, variable import levies and export subsidies. The US by contrast has signaled a willingness to place US agriculture on a more market-oriented footing.

Citrus is only the most current example of our inability to resolve agricultural disputes with the EC under the GATT. Other flare-ups are likely in coming months over export subsidies.

2. Steel

The EC Commission had received authority to negotiate a package deal on steel that resolves, at least temporarily, a contentious dispute over pipe for the All American Pipeline (AAPL). Secretary Baldrige will permit 100,000 tons of EC pipe to enter now, but he reserves the right to count the pipe against Pipe and Tube Arrangement limits later on, if the EC does not complete negotiations for a comprehensive new steel agreement by October 31, 1985. The EC is also committed to reaching agreement on consultation products by July 15, 1985. Without this agreement, our many other restraint agreements could unravel.

3. New Round

Strong French opposition and the "least common denominator" approach have resulted in an EC position which obstructs real progress while offering tepid public support. Differences over a comprehensive review of the international monetary system and CAP reform, and French doubts about its ability to compete in services, high tech and agricultural trade under new rules are behind their resistance to a new round.

It is difficult to conceive of negotiations on agriculture resulting in real progress without EC participation. This is also true for changes in existing GATT rules, e.g. safeguards. Agreements on high tech or services are possible without EC participation, but their practical value will be limited. Many NICs will have far less incentive to join a new round without a reduction in EC barriers to their trade and support for a stronger safeguard regime.

4. Enlargement Issues and GATT

We want to work with the EC to assure that contemplated changes in the EC CXT (Common External Tariff) and the Spanish and Portuguese tariffs are acceptable and in accordance with GATT rules. We prefer that the industrial tariffs of the new entrants be set at the present CXT level since almost all Spanish and Portuguese tariffs are greater than the CXT. If there is a linear balancing of agricultural tariffs, there are extremely complex problems of bound and unbound tariffs that could affect billions of dollars of US agricultural exports to the EC-12.

The Greek case demonstrated a fundamental disagreement over the application of GATT provisions on enlargement. The EC will be positioning itself to limit US exports, and we will refuse to pay twice, for trade lost through diversion to EC suppliers plus that lost because of higher tariffs.

5. Tech Transfer Policy

Our policy of tighter export controls is beginning to have some serious adverse effects on our relations with our allies. They complain that our measures are aimed at maintaining US high technology leadership and commercial advantage. Among measures cited by our allies are: curtailment of the dissemination of scientific and technical information and closing to foreign nationals of certain S&T conferences; tighter distribution license regulations affecting re-export; increased DOD authority to review West-West export license applications; and new safeguard requirements on exports of supercomputers.

We have stressed to our allies that our policies are not directed at restricting the legitimate flow of information to friendly free-world countries. We have offered to discuss specific instances in which they believe our policies or procedures are in fact constraining legitimate West-West technology flows. We also plan to use appropriate existing fora -- e.g. COCOM, OECD -- to reassure our allies regarding the intent of our policies.

III. Relations With The Commission

Our normal interlocutor on trade issues is the Commission, to which authority for trade negotiations -- bilateral and multilateral -- has been delegated by member states. Given the volume of two-way trade (over $100 billion) and direct investment (over $160 billion) involved, differences are not surprising. Few of these issues are solved in formal negotiations at the technical level, where they tend to be treated as a zero-sum game. Successful resolution has generally been through ties we have established at the political level, either through our Ambassador to the EC, who is the cornerstone of the relationship, or directly by Washington officials (Cabinet/Sub-Cabinet to Commission; Assistant Secretaries to Directors-General). At these levels, we have in the past been fortunate to find senior Commission officials (i.e. Soames, Haferkamp, Davignon) who have been imaginative and strong enough to develop solutions which they were willing and able subsequently to sell to member states.

Thus far, there are problems in this respect with the new Commission. Some may simply be due to the fact that it is new and still settling in, and is concentrating first on internal issues -- enlargement, breaking down internal barriers, meeting the challenges of unemployment and high technology. Further, especially in External Affairs, the Commission may be relying too heavily on staff that has become inflexible in its approach to our bilateral problems. But, personalities may present longer-lasting difficulties. While Delors' first visit here served well in establishing personal contact with the President and key Cabinet members, he seems little inclined to get directly involved in trade issues beyond the exhortation level, and his attitudes towards the United States seems at best ambiguous. Willy de Clercq, Commissioner for External Relations, has thus far been rigid and unwilling to take initiatives to resolve problems, although his May 31/ June 1 negotiations with Secretary Baldrige on pipe and tube <u>may</u> represent a positive development. Perhaps reflecting in part his holdover status, Agriculture Commissioner Andriessen has until now been the key exception; he has shown some flexibility and courage in his discussions thus far. He has already met with Secretary Block, and will see Secretary Shultz and others later this month.

IV. Relations with Member States

Clearly, we must also tackle our problems from the member states side as well. Heads of state/government are clearly able, and indeed anxious to stake out national positions at the economic summits. In general, they place greater weight on bilateral ties, a plane on which they can best exercise their personal authority and pursue their national and political interests. European Ministers, on the other hand, generally take greater comfort in the collective decision-making of the Community -- whether (as has been the case of France) to provide a useful shield for national objectives, or (for smaller countries) to gain a stronger voice through cohesion. It is in our interest to increase consciousness in capitals that we consider US-EC differences a part of our bilateral relationships -- the blame for clashes cannot be shifted to an anonymous twelve-side Council of Ministers. By the same token, we need to understand better the domestic political imperatives behind each country's stance on a US-EC issue, bearing in mind that "coalitions" among member states vary with the subject matter. Working with the French, for example, may be more necessary, albeit more difficult, than "conspiring" with more like-minded member states such as the UK and FRG. We should not, however, be seen as trying to circumvent the Commission, or undercut European unity. This would be both contrary to US policy of forty years' duration -- just reaffirmed by the President at Strasbourg -- and counterproductive to our immediate goals. There is a line, which varies with each issue, beyond which the member states, however their views may differ, will react to pressures by closing ranks behind a Community position, defending not only a policy but an institution they have all made political sacrifices to create, and whose continuation and vitality is central to their foreign policies. We will have to judge where this line is on each issue, and use whatever approach is suitable to try to avoid breaching that line.

V. Strategy

We have identified the following major objectives in US-EC trade relations during the months ahead (listed more or less in priority order):

1. Develop effective mechanism and tactics for successfully resolving bilateral trade disputes, including our expected differences in the GATT examination of EC enlargement.

2. Develop closer coordination on preparation for a new trade round.

3. Bring steel negotiations to successful conclusion.

4. Re-engage informal discussions about agriculture to work toward agreement to eliminate agricultural export subsidies.

5. Develop Quad consensus on rollback of protectionism along lines of our proposal last March.

6. Develop coordinated approach to MFA negotiations.

(Multi-Fibre Agreement)

7. Work to defuse concerns about restrictions on access to technology.

Regarding the substance of our objectives, the following observations would guide our approach:

Agriculture

Through a combination of bilateral discussions with the EC, multilateral talks in the GATT, and, where necessary, trade actions to defend our interests, we need to persuade the Community that we have a common interest because of over-production and high budget costs in bringing policy more in line with market forces and in imposing restraint on the use of agricultural export subsidies. Furthermore, we need to make clear that market sharing, the Community's preferred approach to resolving our disputes in international markets, it not an acceptable substitute for discipline over export subsidies.

Steel

At root, our task in arriving at a satisfactory arrangement governing steel trade is to convince the EC that its structural adjustment problems cannot be exported to the United States. It will be extremely difficult for the Community to work out the internal burden sharing which is a prerequisite of any viable agreement with us.

Our approach must be to use a judicious combination of carrots and sticks which leave no doubt in the Commission or the Member States that, either through an arrangement or through unfair trade cases, we will assure an equitable sharing of burdens as steel industries on both sides of the Atlantic pass through this painful period of adjustment. Our objective should be to reach an agreement this summer which permits us to put this issue behind us and concentrate our energies on addressing trade issues of the future.

New Round

We are convinced that greater liberalization of the world trade system is in the interest of all trading nations. Concerned that protectionist pressures in many countries, including the US as well as the EC and Japan, are leading toward trade restrictions, we believe a New Trade Round is necessary to regain momentum in support of freer trade. Clearly, multilateral trade negotiations will be more fruitful if they include all major trading partners. Our primary objective is full EC participation in the new round. However, if the Community fails to achieve a consensus on starting a new round or tries to impose conditions unacceptable to the US, we should move ahead in those areas, e.g. services or high technology products, in which EC participation, although desirable, is not indispensable to some additional liberalization beyond current levels in many of our other world markets. Initiation of negotiations with like-minded countries may convince the Community not to stay on the sidelines. If it does not, we can in any event begin to reduce some trade barriers among those countries willing to negotiate, as has been done, for example in the case of the MTN codes.

EC Enlargement

During the coming months negotiations will begin in the GATT to determine whether the Community of 12 meets GATT requirements for a customs union, and to work out bilateral claims arising from the tariff changes that accompany the enlargement. We must continue to make clear to the EC that, while we support enlargement, we will not agree to a trade "credit" or any other approach which places unwarranted barriers on US export. Since the EC intends to reveal its proposed new tariff schedule in January 1986, we should use the intervening months to dissuade it from building the idea of such a "credit" into the new tariffs.

There are several opportunities for advancing many of our objectives in coming months. However, there are also new initiatives which we should consider for enhancing the chances for success. A timetable for action includes the following events and opportunities:

June through July

-- Negotiations on steel, following up on Secretary Baldrige's agreement with de Clercq of June 1.

-- Meeting of US-EC working group on high technology.

-- Visit of Commissioner Andriessen, during which we can explore the possibilities for giving new impetus to our informal dialogue on agricultural issues at the Director General/Under Secretary level, as well as the future of the GATT Committee on Trade in Agriculture.

-- Quadrilateral (US, Japan, Canada, EC) meeting in Canada: an opportunity to discuss issues related to preparation of a new trade round; explore possibilities for advancing toward agreement on our rollback proposal, and, if appropriate, to have an initial exchange on MFA negotiations.

July or September

-- Meeting of Senior Officials in GATT to begin preparations for new trade round.

-- Meeting of Senior Agriculture Officials in context of GATT Committee on Trade in Agriculture.

November

-- In addition to GATT Council meetings leading up to it, the annual meeting of GATT Contracting Parties in November will offer opportunities to discuss many of the issues involving our main objectives.

December

-- Meeting at Cabinet level between US and EC Commission.

The key to a successful strategy lies in establishing the basis for a constructive relationship in the weeks ahead. Assuming a Presidential decision to retaliate on citrus, we must anticipate at least a mini-explosion in US-EC relations, with the possibility of counter-retaliation by the EC. While the dust is settling, both Ambassadors Yeutter and Middendorf will be taking up their new jobs. This gives us an opportunity to begin building a new relationship.

Particularly critical is the need to convince the Member States of the necessity of seeing that the positions they take in the EC Council affecting relations with the US are an important aspect of our bilateral relationship as well. The proposals outlined below are designed to lay special emphasis on engaging the Member States more forcefully in responsibility for US-EC relations.

USTR-designate Yeutter plans post-Labor Day travel to Brussels and key EC capitals to review trade relations. His visit, which should be coordinated with the efforts of Ambassador Middendorf, who will take up his position at USEC in July, could convey at a high level our concern about the drift of our relations toward confrontation, the reasons behind it and the implications as we see them, and possible ways of dealing more constructively with our mutual problem. He could carry, or be preceded by, a letter from the President expressing a similar theme. If deemed useful, a small, Assistant Secretary-level team could precede or follow this tour.

The objective would be to bring back for EPC consideration recommendations about how best to construct and manage our trade relationship with the EC and to present options for dealing with each of the main issues on our agenda. Recommendations should include an assessment of which issues seem most likely to be negotiable over the near term and which may require some action by the US, either to pave the way to a settlement or in lieu of one. We should make it clear that the purpose is not to negotiate about specific issues, but rather to take a close look at the relationship as such.

There are a variety of new proposals for better management or internal strategy development and coordination which we could examine in the light of the tour. These include:

(1) Creation of an informal Assistant Secretary/ Director General-level group which could meet once or twice a year to discuss underlying themes in the US-EC relationship. (If the first such meeting takes place in late October, it would serve both to follow up the Yeutter tour and help prepare for the December Cabinet-level meeting.)

(2) Suggest a meeting between the Secretary of State and the Foreign Ministers of the EC "Troika" (the immediate past, present and future presidency countries), perhaps at the annual UNGA session in September.

(3) Ensure that the opportunity of the December Cabinet level meetings with the Commission becomes the occasion for an intensive review in the Cabinet of US-EC relations and the coordination of strategy for dealing with them. Provide for a similar internal review each Spring. The US Ambassador to the EC should participate directly in both meetings and their preparation.

VI. Congress

We need to make sure we're getting credit in Congress wherever possible for trade policy. For example, when the President makes his decision on citrus, Congress should be briefed, putting the decision in the context of our efforts to invigorate the GATT dispute settlement process and to break out of the logjam of agricultural cases with the Community.

Similar briefings should be arranged on the steel agreement and our negotiating objectives for renewal of the 1982 accord. Finally, we should discuss with key members our plans for use of the export PIK, and the potential need to modify it if a breakthrough on export subsidy talks occurs. If it's decided to send a team to Europe, Congress should be briefed to make sure this isn't seen as an effort to talk the problems to death.

THE SECRETARY OF ENERGY
WASHINGTON, D.C. 20585

June 7, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: John S. Herrington John S. Herrington

SUBJECT: Cook Inlet Crude Oil Exports

ISSUE: Should the Administration pursue the actions necessary to permit the export of Cook Inlet crude oil?

Background

- In bilateral discussions, Japan and Korea have indicated strong interest in importing crude oil from Alaska. They believe that access to U.S. crude will help further diversify their sources of supply and enhance their energy security.

- The Reagan-Nakasone Joint Statement on Japan-U.S. Energy Cooperation in November 1983 recognized the benefits of lifting the restrictions on crude oil exports and stated that the "U.S. will continue to keep under review the removal of restrictions on exports of domestic crude oil."

- While the export of Alaskan North Slope (ANS) crude is effectively prohibited by law, fewer legal constraints apply to oil produced in Alaska's Cook Inlet.

- There are five separate but often overlapping statutes that restrict exports of U.S. crude oil, but the restrictions of four of them (the EAA is the exception) can be waived by specific Presidential findings.

  - the Export Administration Act (EAA), which restricts only Alaskan North Slope oil;

  - the Mineral Lands Leasing Act (MLLA), which restricts the export of any oil that crosses a federal right-of-way, as defined in the MLLA;

  - the Outer Continental Shelf Lands Act (OCSLA), which restricts the export of OCS oil;

  - the Naval Petroleum Reserves Production Act (NPRA) which restricts NPR crude (and refined product) exports; and

  - the Energy Policy and Conservation Act (EPCA), which restricts all domestic crude oil exports.

- Cook Inlet oil is subject to just one statute, EPCA, because production is from state waters (not OCS), and because the gathering lines that bring the oil to shore terminals do not cross any MLLA right-of-way.

- Cook Inlet exports would be possible if:

  - the President or the Secretary of Commerce found under the Energy Policy and Conservation Act (EPCA) that such exports are in the national interest; and

  - the Department of Commerce amended its Export Administration Regulations.

- Total Cook Inlet production is about 60,000 barrels per day (B/D) of 35° API waxy crude, declining at 15 percent per year. About 15,000 - 30,000 B/D is being made available for export by Tesoro's decision to upgrade its refinery at Cook Inlet to run higher sulfur ANS crude.

- The other 30,000 B/D of production is owned by Union Oil and used in Union's West Coast refinery; Union does not want to export this crude at present.

- Governor Sheffield in March wrote to Prime Minister Nakasone offering to sell Japan Alaska's royalty share of Cook Inlet production (6,000 B/D). The Republic of Korea has also expressed its interest in this crude.

- The Far East could be a more profitable market for Cook Inlet crude than the lower-48 because of lower shipping costs. The estimated per barrel cost to ship to Japan is $.67, compared to $1.24 to the West Coast and $4.35 to the U.S. Gulf.

- Exports would therefore yield higher netbacks to producers. Much of the gain would accrue to government through higher State and federal tax and royalty receipts.

- Since the crude to be exported is refined and consumed in Alaska, it does not now use U.S. tankers. Even if shipped to the lower-48, it would only employ 6-8 tanker trips per year.

- Consultations with members of the Congress on Cook Inlet exports have uncovered strong opposition from some members. A decision to allow export of Cook Inlet would require development of a legislative strategy with input from the White House, and the Departments of Commerce, Energy, State and Transportation to insure that the initiative is properly explained and that other pending legislation, such as Energy Policy Conservation Act (EPCA) and the Export Administration Act (EAA), is not adversely affected.

- Opposition would also be encountered from Maritime interests who may fear that export of Cook Inlet oil would be the first step to remove controls on export of ANS crude oil.

- Were the President to issue the requisite EPCA finding, the Commerce Department advises that it would take approximately 3 months to complete the regulatory revisions allowing actual export.

Options

- There are three basic options regarding the export of Cook Inlet oil: (1) move to allow such exports; (2) pursuing Cook Inlet exports only as part of a broader strategy to liberalize Alaska North Slope and other U.S. crudes; and (3) delay a decision on Cook Inlet pending consultations with the Congress to see what export strategy would be acceptable.

Option 1: Allow Cook Inlet oil to be exported: Initiate a national interest finding; direct the Department of Commerce to make the necessary regulatory changes; and implement approach to Hill to gain acceptance.

Advantages

- This option is consistent with Administration policy to rely on the market by removing remaining barriers to trade.

- By fulfilling one of the commitments on energy cooperation, this action will be viewed positively by Japan and Korea, and will be useful in discussions on other energy issues such as coal and LNG.

- Producers of Cook Inlet oil would find a closer, more profitable market in the Far East compared to the lower-48. Federal and State treasuries would gain more in royalty and tax receipts from Cook Inlet oil exports.

- Export would demonstrate U.S. commitment to the energy security concerns of key allies.

- Limited Cook Inlet exports could over time improve the climate for export of ANS crude.

Disadvantages

- Given the small amount of crude involved (15,000-30,000 barrels per day) national security benefits would be small, as would energy security benefits to recipients (i.e. 15,000 B/D represents less than 1 percent of Japan's crude imports.)

- Congressional opposition could be very strong and may endanger passage of other legislation such as the EAA and EPCA.

- Would require developing rational as to why only export controls on Cook Inlet oil are being lifted but not controls on any other oil that might be equally eligible for export under EPCA.

Option 2: Do not allow Cook Inlet oil to be exported at this time; instead, await and strive for liberalization of the export controls on Alaskan North Slope and other crude oil, before allowing Cook Inlet oil to be exported.

Advantages

- This approach would avoid a potentially divisive confrontation with the Congress for the export of a small volume of crude.

- The real gains from exporting Alaskan oil are based on a significant savings in transportation and refining activities which would arise from allowing larger volumes of exports. Permitting exports of Cook Inlet oil would have small economic benefit.

Disadvantages

- This comprehensive approach could significantly delay further success in liberalizing the export of certain crudes in which buyer and seller interest has been expressed, as in the case of Canada and Cook Inlet.

- The Administration could be perceived by allies (Japan and Korea) as unwilling to tackle the crude oil export issue, and this could lead them to modify any efforts on their part to increase imports of other U.S. energy resources.

- Permitting Cook Inlet oil exports would be a first step in fostering economic efficiency in oil transportation. It would demonstrate to opponents of Alaskan North Slope oil exports that lifting an injunction on free trade would allow rather than require, producers to sell oil based on the relative profitability of markets.

Option 3: Delay a decision on Cook Inlet exports pending consultations with members of Congress on Cook Inlet exports and the broader issue of crude oil exports to determine what strategy or volume of export would be acceptable.

Advantages

- Would allow time to gauge the climate in the Congress and might result in the formulation of an export strategy that would have a greater chance of success.

Disadvantages

- Strategy might delay prospects for Cook Inlet exports and be interpreted as reluctance on the part of the U.S. to undertake an export initiative.